



WIDENING THE RETIREMENT SECURITY ADVICE GAP:

**Why the Senate Democrat Pension Reform Bill
is Too Weak to Protect U.S. Workers**

An Analysis by:

U.S. Rep. John Boehner (R-OH), Chairman
House Committee on Education & the Workforce

September 5, 2002

WIDENING THE RETIREMENT SECURITY ADVICE GAP:

Table of Contents

Introduction

Key Findings

- I. The Need for Broad-Based Worker Access to Advice**
- II. The Bipartisan House Plan to Close the Investment Advice Gap**
- III. Why the Senate Alternative Doesn't Solve the Problem**

Conclusion

INTRODUCTION

Thousands of workers lost their retirement savings in recent collapses at Enron and WorldCom, and President Bush has called for congressional action to shield American workers against losing their life's savings in similar corporate meltdowns. On April 11, the Republican-led House of Representatives passed the bipartisan *Pension Security Act* (H.R. 3762) – authored by House Education & the Workforce Chairman John Boehner (R-OH) and Rep. Sam Johnson (R-TX) – with the support of 46 House Democrats. Since then, the legislation has been stalled in the Democrat-controlled Senate, which left for the August break without sending President Bush a pension protection bill. Senate Democrat leaders have indicated they will take up the issue after Labor Day.

A pension reform package sketched out by Senate Democrat leaders in late July would mirror bipartisan pension protection legislation passed by the House in most respects – but with at least one potentially devastating weakness for American workers. **The proposed Senate Democrat bill would gut a provision, passed twice by the House with significant bipartisan support and supported by President Bush, that would enable millions of rank-and-file workers to gain access to professional investment advice that could have helped workers at Enron and WorldCom protect their 401(k) accounts.**

The House passed the investment advice bill as part of the *Pension Security Act* in April and last November as a stand-alone bill (H.R. 2269 – the *Retirement Security Advice Act* – authored by Boehner) with the full support of 64 House Democrats (nearly a third of the House Democrat Caucus), including Democratic Conference Chairman Martin Frost (D-TX). **The decision by Senate Democrat leaders to gut this provision seriously weakens their pension reform package and would leave too many workers vulnerable to the type of devastating losses suffered by employees in recent collapses.**

Professional investment advice is a pension security protection few working families can afford today. Senior corporate insiders typically enjoy the protection of a professional advisor who can warn them when they have “too many eggs in one basket.” But few working families today can afford such a luxury. Employees have been asking for greater access to investment advice for years – but outdated federal laws, written more than a quarter-century ago before the advent of the 401(k) – discourage employers from providing it to them.

Congressional hearings and investigations have established that inadequate worker access to investment advice contributed significantly to retirement security losses by employees at Enron. Tom Padgett, a participant in the Enron Corp. 401(k) savings plan, was an employee with 30 years of credited service at its Morgan's Point Chemical Plant in LaPorte, Texas until August of 2001, when Enron transferred his plant to EOTT Energy Corporation, an Enron subsidiary. He invested his 401(k) savings plan entirely in Enron stock. The value of his savings account on December 31st, 2000 was \$615,456; now he estimates the savings account is worth less than \$15,000.

On February 7, 2002, Tom Padgett testified before the House Committee on Education and the Workforce about his experience at Enron: “I have lost nearly all of my retirement savings because of Enron's collapse. It appears I will need to work for another 10 years or as long as my health holds out in order to support my family,” Padgett told committee members. “I believe the law should protect workers and their retirement savings from what happened at Enron.”

"I never dreamed that this disaster could have happened. **We are not Wall Street analysts. I am sure that most Enron employees manage their investments themselves, like Karen [his wife] and I did,**" Mr. Padgett testified.

During the hearing, Mr. Padgett was asked: "Did you receive any information, or as I would describe it, investment education from your employers or others talking about the need to diversify your account?" Padgett responded without hesitation: "No sir."

Enron and WorldCom, like most U.S. companies today, do not provide its rank-and-file workers with access to investment advice. The House-passed *Pension Security Act* would fix outdated federal laws to allow employers to provide their workers with high-quality, professional investment advice as an employee benefit while making advice providers personally liable for any advice not provided in the employee's best interest. **By stripping this bipartisan provision out of their pension reform bill, Senate Democrats have seriously weakened prospects for enactment of legislation that will truly protect American workers from losing their retirement savings in corporate collapses,** this analysis by House staff concludes.

KEY FINDINGS

- **Inadequate worker access to investment advice contributed significantly to retirement security losses by employees at Enron and WorldCom.**
- **The explosive growth of 401(k) plans has helped rank-and-file workers save for retirement, but also left them with the responsibility for investment decisions many are not equipped to make without professional investment advice.**
- **Outdated federal pension laws – enacted before the advent of the 401(k) – deny U.S. employees access to quality investment advice. A chronic “advice gap” has emerged between senior corporate insiders and rank-and-file workers. Senior company executives can afford to pay for quality investment advice, while few working families can afford such a luxury.**
- **The bipartisan House-passed pension reform bill, supported by President Bush, would help to close the investment advice gap for millions of U.S. workers by providing new access to quality investment advice, along with strict and comprehensive protections for workers.**
- **The Boehner advice bill would encourage employers to offer high quality, professional investment advice. The Senate Democrat plan (S. 1677) would not encourage employers to offer advice benefits because it would *significantly increase* the cost and administrative burden required of employers to provide these services.**
- **As a result, the proposed Senate Democrat pension reform bill would leave most American workers in virtually the same condition they’re in now – with no access to high-quality, professional investment advice about their pensions and 401(k) accounts.**

PART ONE: The Need for Broad-Based Worker Access to Investment Advice

The heartwrenching worker losses at Enron and WorldCom were foreshadowed by Yale Law School Professor John H. Langbein in testimony before a House subcommittee hearing on February 15, 2000 – nearly two years before the collapse at Enron. Appearing before the House Education and the Workforce Subcommittee on Employer-Employee Relations, Langbein discussed the need to modernize the Employee Retirement Income Security Act (ERISA), the nation's primary pension and employee benefit law, to allow millions of workers to have better access to investment advisors who could alert them about the need to diversify their savings.

"The explosive growth of defined contribution [401(k)] plans has left employees with the responsibility for investment decisions that they are ill-equipped to make," Dr. Langbein warned members. "Congress needs to revisit ERISA's barriers that currently prevent employers and investment intermediaries from giving individualized investment advice to plan participants."

"Advice Gap" Threatens Worker Pension Security

- Langbein and other witnesses warned Congress that the dramatic growth in employee 401(k) plans – while offering clear advantages for workers saving for retirement – had also resulted in the emergence of **a troubling advice gap between rank-and-file workers and senior company insiders**, who can afford to hire professional investment advisors to provide them with quality advice regarding their savings and investments. Few working families can afford such a luxury.
- "In a defined benefit plan, the responsibility for setting investment policy rests with the employer's financial officers and their expert advisers," Langbein noted. "By contrast, in a 401(k) plan it is the employees (who often have no financial sophistication) who make important elections about how to invest their individual accounts."

Outdated Laws Deny Workers Access to Investment Advice

- Langbein observed that many U.S. employers have acknowledged the problem and are willing to pay for professional investment advisors for their workers – but they're effectively barred from doing so by outdated federal pension law, written before the rise of the 401(k), which may place fiduciary responsibility – and thus legal liability – on the employer, rather than the advice provider, where it belongs.
- "Employers and investment intermediaries would like to assist employees to make the most of their retirement savings, but they fear liability as fiduciaries if employees should buy into what turns out to be a down market," Langbein testified. "Existing law allows employers and others to provide employees with vague so-called 'education' about the investment process and about the particular investment choices available, without becoming ERISA fiduciaries. . . [But ERISA] treats the giving of 'investment advice' as a fiduciary function."

An employer who arranges for financial professionals to deliver the tailored financial advice that individual employees need risks being deemed an ERISA fiduciary.”

- This outdated approach, Langbein said, **leaves millions of American workers without the tools needed to effectively protect and grow their retirement investments.**
- “The result is that ERISA has been read to insist that individual workers by the millions should become investment experts. It has not happened, it cannot happen, and it is causing workers to be less well invested than if employers and investment intermediaries were allowed to guide the individual employee on the asset allocation appropriate to his or her place in the life cycle, family circumstances, and other assets,” Langbein said.

PART TWO: The Bipartisan House Plan to Close the Investment Advice Gap

As the Enron and WorldCom collapses tragically illustrated, millions of rank-and-file American workers today have little or no access to quality investment advice that can provide critical guidance to help them manage their 401(k) plans. The House addressed this issue last November when it passed the *Retirement Security Advice Act* (H.R. 2269), authored by Rep. John Boehner (R-OH) and Rep. Sam Johnson (R-TX), by a vote of 280-144 with bipartisan support of 64 Democrats.

The House passed the bill again as part of the more comprehensive *Pension Security Act* (H.R. 3762) on April 11, 2002, again with significant bipartisan support. Forty-six House Democrats voted “yes” despite heavy pressure from Democrat Minority Leader Dick Gephardt to block the bipartisan House pension reform bill, which President Bush has indicated he is eager to sign into law.

Outdated Federal Law Discourages Employers From Offering Access to Advice

The Employee Retirement Income Security Act (ERISA), enacted in 1974 before the advent of the 401(k), creates barriers that currently prevent employers and investment providers from giving individualized investment advice to workers. The bipartisan House-passed pension reform legislation updates this outdated law by allowing employers to provide their workers with access to professional investment advice as a benefit as long as advisers fully disclose any fees or potential conflicts. It also includes significant safeguards to ensure that workers receive advice solely in their best interests.

Solving Liability Questions Will Encourage More Investment Advice

Many employers want to provide access to investment advice as an employee benefit but federal liability standards on employer-sponsored investment advice are vague and unclear. The bipartisan House-passed pension reform bill clarifies that employers are not responsible for the individual advice given by professional advisers to individual participants, removing the barrier to

employers contracting with advice providers and their workers. Employers will remain responsible for the prudent selection and periodic review of any investment adviser and the advice given to employees.

Fiduciary Duty + Disclosure = Important New Protections For Workers

Fiduciary Safeguards. The bipartisan House-passed pension reform bill includes important safeguards and new protections to ensure that workers receive quality advice that is solely in their best interests. Under the bill, only qualified “fiduciary advisers” that are fully regulated by applicable banking, insurance, and securities laws may offer investment advice. This ensures that individuals who provide advice will be qualified.

Under the bipartisan House-passed bill, investment advisers who breach their fiduciary duty will be personally liable for any failure to act solely in the interest of the worker, and may be subject to civil and criminal penalties by the Labor Department and civil penalties by the worker, among other sanctions. **This is the highest form of duty and loyalty the law provides.** In addition, existing federal and state laws that regulate individual industries will continue to apply.

Comprehensive Disclosure Protections. In order to provide advice under the bipartisan House-passed bill, advice providers must disclose in plain, easy-to-understand language any fees or potential conflicts. The bill requires advisers make these disclosures when advice is first given, at least annually thereafter, whenever the worker requests the information, and whenever there is a material change to the adviser’s fees or affiliations. The disclosure must also be reasonably contemporaneous with the advice so that employees receive the disclosure when they receive advice instead of with binders of other papers on their first day of work. These types of disclosure obligations, along with fiduciary duties, have worked well in regulating the conduct of advisers under federal securities laws for more than 60 years.

Assistant Secretary of Labor Ann Combs, the nation’s chief pension law enforcement official, praised the worker safeguards in the House-passed bill, saying that, *“combined with ERISA’s existing strong disclosure and fiduciary protections, [they] provide the Department with the tools that should enable us to protect workers from abuse.”*

Workers Would Have Full Control Over Their Investment Decisions

The bipartisan House-passed pension reform bill does not require any employer to contract with an investment adviser and no employee is under any obligation to accept or follow any advice. Workers will have full control over their investment decisions, not the adviser. This legislation will foster a competitive, dynamic investment advice marketplace that serves worker needs but also establish a strong, protective framework that safeguards their interests. The pension and investment world has changed dramatically in the 25 years since ERISA was enacted. The House-passed bill reflects Members’ belief that the time has come to modernize ERISA so it reflects the financial realities and challenges of today’s economy.

Testifying before the House Education & the Workforce Committee earlier this year, Secretary of Labor Elaine Chao asked the question “*Why should only the CEOs get good financial advice?*” The House-passed pension reform legislation addresses this troubling advice gap between

rank-and-file workers and senior company insiders and provides the type of professional investment advice that will help workers protect and expand their retirement savings.

New Tax Incentives for Investment Advice

The *Pension Security Act* also provides a new tax incentive, authored by Rep. Rob Portman (R-OH), to help employees pay for the cost of retirement planning services. Employees may use a pre-tax payroll deduction to help pay for retirement savings advice and counseling.

PART THREE: Why the Senate Alternative Doesn't Solve the Problem

Congress should encourage, rather than discourage, employers to provide investment advice benefits to their workers. The proposed Senate Democrat pension reform bill fails this important test. Unfortunately, the Senate has failed to consider advice legislation that would offer workers the strong protections of the House-passed Boehner proposal or allow the nature of the advice services to adapt to worker needs. The Senate Democrat bill leaves in place a significant barrier in current law that needlessly denies workers access to the advisers who are best positioned to provide quality advice. **As a result, it will not increase employee access to advice, and American workers will be left in virtually the same condition they're in now – with no advice at all.**

The so-called "Independent Investment Advice Act," S. 1677, introduced by Senator Jeff Bingaman (D-NM) and included in Senate Democrats' proposed pension package, would purportedly increase worker access to investment advice. But instead of doing so by building on a tried-and-true regulatory structure and allowing the market to conform its advice services to what workers want, the Senate Democrat proposal creates a regulatory loophole and would have the effect of limiting workers to solely Internet-based investment advice services. Not surprisingly, prominent Internet-based advice companies have led the charge against the bipartisan House bill, which would open the advice market to greater competition.

The core of ERISA's regulatory framework is the fiduciary duty that pension managers and related parties owe to the plans they manage. As noted in Part Two, the fiduciary duty is the highest duty of loyalty and prudence in the law. It requires plan managers and related parties to act solely and at all times in the best interests of the plan; any action which is not intended for the exclusive benefit of the plan is itself a violation of this duty. There is no higher standard of undivided loyalty in the law – state or federal. Enacted in 1974, this structure has provided employers enough flexibility to design their plans in response to their needs and their workers' needs instead of a one-size-fits-all Washington approach.

The Boehner approach incorporates these strong fiduciary protections, clearly applying the fiduciary duty to the employer's selection of advisor and advice service and to the investment advisor's own conduct. This would allow employers to provide their workers with the best advice possible, given the specific needs of their workers and the specific nature of the investment choices available. But the proposed Senate Democrat bill sidesteps these protections. Instead, it creates a so-called safe harbor for employers who satisfy the bill's checklist of requirements –

chiefly, that they select licensed advisors whose companies have no other financial relationship with the plan.

Ostensibly this may seem to some a fair trade-off for workers – allowing employers to escape the broader and higher standards of the fiduciary duty when selecting advisors in exchange for choosing advisors whose firms have no connection with the pension plan or any of the pension plan’s investment options. **But the losers in this bargain are the workers who probably need investment advice the most.** Consider:

- **PROMOTING LOW-QUALITY ADVICE.** The Senate Democrat plan (S. 1677) would limit the field of investment advisors to small advice firms who offer face-to-face advice services and firms which offer their advice solely on the Internet. The first option would be ideal but is prohibitively expensive, meaning few employers will be able to offer advice benefits to their employees because it would *significantly increase* the cost and administrative burden required of employers to provide these services. The second option – Internet-based advice driven by computer models – has simply not demonstrated any success in affecting investor choices. Thousands of workers already have access to computer-provided investment education services, and there is strong evidence that most of these workers simply aren’t comfortable receiving their information through this manner. What would likely work best is an integration of computer-generated advice and telephone call centers, but the current web-based firms simply aren’t big enough to provide phone access to their own advisors. In contract, the Boehner approach would allow a variety of delivery systems to evolve in response to what workers need.
- **LIMITING CONSUMER CHOICE AND COMPETITION.** By closing the investment advice market to the vast majority of firms who provide investment advice directly to individuals, the Senate Democrat plan fundamentally limits competition among investment advisors, stifling innovation, price discipline, and quality. Imagine not being allowed to buy a car through a manufacturer-related dealership, or not being allowed to buy supermarket-produced food brands from a supermarket. Either limitation would restrict consumers’ choice and deny them products that might actually best serve their needs. So, too, does S. 1677 foreclose workers from investment advice products which might best get them the information they need in a manner they’ll respond to.
- **NO DISCLOSURE REQUIREMENTS.** S.1677 does not require disclosure to participants of any of the fees, compensation, or affiliations with respect to the advice services provided by the “independent” advice provider. Under the bill, participants will lack even the basic information they need to make informed decisions regarding the quality of an advice provider, the quality of its product and services, and the fees or compensation it receives for the advice it provides. S.1677 also has no mandated record retention requirements to document the advice that is given to participants.

In short, when S. 1677 trades away the fundamental worker protections in ERISA’s fiduciary duty regime, workers are the losers. The irony is that this approach – prohibiting affiliated advisors from providing advisory services – is unnecessary given the extraordinarily high standards of loyalty and prudence that ERISA would subject advisors to under the Boehner bill. Consider:

- Investment advice to ERISA plan participants is regulated not just by ERISA, but by the Investment Advisors Act, enforced by the SEC, and by other federal and state banking, insurance, and securities laws. In addition, pursuant to federal securities laws, the major stock exchanges are treated as self-regulating organizations that also apply significant investor protections to the investment firms that trade with them.
- There have been significant allegations that some investment firms offered investment analysis tainted by internal conflicts. But since these allegations were made, the securities regulators have responded forcefully. New York's attorney general settled charges against one Wall Street firm that resulted in significant operational changes to protect the integrity of investment analysis. Both the New York Stock Exchange and the NASDAQ – the two dominant U.S. stock markets – have imposed additional protections to ensure that firms act appropriately, and the SEC has followed suit.
- Congress has already acted on the broader issue of analyst conflicts where this issue belongs – in the securities laws. The recently enacted Sarbanes-Oxley Act adopted language calling on the SEC to determine whether additional protections are necessary to ensure that investment analysis is untainted by conflicts of interest. Both the House Financial Services and Senate Banking Committees actively studied allegations of tainted analysis and advice, and both could easily have proposed all federally licensed investment advisors to be independent. Neither did – in fact, neither even considered it.

CONCLUSION

Thousands of workers lost their retirement savings in recent collapses at Enron and WorldCom, and congressional action is needed this year to shield American workers against losing their life's savings in corporate meltdowns. Inadequate worker access to investment advice has contributed significantly to recent retirement security losses by U.S. employees, and strong provisions to improve worker access to quality advice are an essential element of meaningful pension protection.

The pension reform package sketched out by Senate Democrat leaders in late July would leave most U.S. workers in the same unacceptable situation they're in now – with no access to quality advice about their 401(k)s. While mirroring the House-passed pension reform bill in many respects, the proposed Senate Democrat bill would needlessly gut a provision, passed twice by the House with significant bipartisan support and supported by President Bush, that would enable millions of rank-and-file workers to gain access to professional investment advice that could have helped workers at Enron and WorldCom protect their 401(k) accounts.

Senate Democrats should rethink their approach to the employee investment advice issue and follow the Republican-led House in passing a strong pension reform bill that will truly protect the retirement security of America's workers.